Foreign Direct Investment in Kosovo and possible avenues for change

Kyle Conahan

M.A. in Political Science
With a Concentration in European Union Policy Studies
James Madison University

Abstract

Foreign Direct Investment (FDI) is very beneficial in assisting economic development in underdeveloped economies. The positive contributions can be seen in the spillover effects, employment creation, and increase in available capital. As a post conflict society, Kosovo is still rebuilding its society and institutions. Various sectors of the economy are underperforming or are not fully developed. Most noteworthy, the agricultural sector remains underproductive. The demographics and laws on the books provide positive conditions for possible investment. The average age in Kosovo is 35 and corporate taxes are very low at 10%. Industries have been privatized and several economic zones (EZs) have been established to further encourage inflows. Several industries lend themselves very well to foreign investment such as energy, agriculture, tourism and telecommunications. Yet foreign investment does not flow in at the rate that one would think. This is because of corruption and low public trust in institutions. The government of Kosovo remains a big question mark as it is unclear if contracts will be enforced and property protected. Aside from institutional problems, poor infrastructure and unreliable electricity further exacerbate the problem. Kosovo has the potential to be a productive economy, but major reforms are necessary.

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Introduction

Foreign direct investment (FDI) has resulted in noticeable gains for underdeveloped economies. Kosovo has a small economy that can be greatly affected by foreign direct investment. Only slightly larger than the state of Delaware and a population less than two million, Kosovo's economy is fragile, but also morphable (CIA 2017). This paper will discuss why foreign direct investment should be considered as a component of the Kosovo economic development strategy. It will begin with a discussion of the effects of foreign investment on local economies. This will be followed by a brief background about the development of Kosovo in terms of economic development. The paper will then move to discuss various stakeholders in Kosovane economic policy. Afterwards, a description of the current Kosovane economic development strategy will be outlined and analyzed. This analysis will also look at other factors that may influence development, such as the strength of institutions and other structural elements. Following the description of the current status quo, a section will outline possible policy alternatives and suggestions to improve the flow of investment to Kosovo. The paper concludes with comments on the prospects of the Kosovane economy over the next ten years.

Why care about Foreign Direct Investment

Foreign Direct investment has been linked to various improvements in underdeveloped economies. The positive contributions of foreign direct investment can be seen in the spillover effects, employment creation, and increase in available investment capital. Its spillover effects can be grouped in horizontal and vertical gains. Horizontal gains are highlighted by the transfer of technology from foreign firms to local firms at the same level of operation but at a different technological level. This technology is imitated by local firms through reverse engineering, leading to an overall increase in technological sophistication of a sector. Additionally, the labor employed by foreign investors are trained by the foreign firms to create the skill sets required for projects in local countries (Magomberi 2017). This training brings the skills of employees to the standards of the foreign firm which are generally higher than the local countries. The skills are not only those to perform tasks, the training also creates marketing and management skills. If these employees decide to leave the foreign firm, these skills can be used by local labor to start more competitive and productive local businesses. This then leads to new labor being hired by trained professionals who can in turn train their labor to be more productive (Magomberi 2017).

The vertical component of spillovers is seen in the new competition and demand in local markets. Foreign firms will demand resources from the local market instead of shipping resources from other locations. This creates more demand for local goods which leads to the expansion of local firms, creating employment. This pressure for resources on local firms for local goods and services forces local firms to become more competitive and improve quality. They will adopt new technology and begin investing more in their business because of the profits yielded by the increased demand (Magomberi 2017).

The employment created from FDI is more clearly seen than the spillover benefits. As foreign firms invest in countries they need to hire local labor to staff and carry out tasks. This naturally decreases unemployment. The wages received from this new employment creates new capital that can be used for investment. The wages coming from foreign countries being paid to local labor acts as new money that allows for labor to consume and use or to purchase more or higher quality goods and services. These wages can also be saved and put into banks, then can be lent out to entrepreneurs, creating more local employment. An additional benefit of FDI is the increase in government revenue. Foreign firms must pay taxes to local governments to conduct business in the country. With more foreign firms investing, more government revenue is generated without placing a higher tax burden on the citizens. This new revenue allows for governments to provide better and more services to citizens (Magomberi 2017).

Foreign direct investment inflows are particularly effective in countries with two specific characteristics. The first is that the country has low income levels. The positive effects of FDI are most clearly seen in countries with low levels of economic development. Countries with a higher development level already have many of the effects of FDI entrenched in their economy and the effect of FDI is limited. Conversely, in underdeveloped economies where FDI can truly change the economy because the various spillover effects will have a stronger impact. The second characteristic is that the country possesses high levels of social capabilities. Social capabilities are strong institutional framework, effective means of communication, well-educated labor force, and infrastructure support (Magomberi 2017).

The most important social capability is a strong institutional framework. A strong institutional framework not only promotes FDI, but also foreign aid flows. Foreign firms will not invest in countries where their investments will be expropriated by the host government. When a foreign firm invests in a country a host government has two options. It can either seize the investment and take it as its own, or leave it alone (Jin 2016). If the host government decides to seize the investment, FDI inflows will stop as foreign investors will be scared off by the governments policy decision. However, if the government decides to leave the investment alone, not only will it contribute positively to the economy, foreign aid will also flow to the host government. Foreign governments have a responsibility to their industry to make sure they are growing and generating profits. To further protect the foreign investment, foreign governments will provide additional assistance, usually in the form of financial assistance to host governments. This prevents the host government from expropriating the foreign investment and benefits the host government on a two-way front. Not only will it experience the gains from the foreign firm's investment, it will also receive financial assistance from the foreign government (Jin 2016).

Background

When Kosovo was part of Serbia and more generally Yugoslavia, it was an agriculturally focused part of Serbia. Kosovo did not have large cities or major roads. It was a hub for agriculture. This resulted in small to no urban centers and a complete lack of infrastructure able to support large sustainable growth. This persists today, with the population scattered around the country and the only large population is the capital Pristina. Most property records were destroyed by Serbia in 1998-1999 making the determination of ownership very difficult. It is common the multiple people will claim ownership of something with each person having the partial paperwork (ITA 2017b). During its counter-insurgency and war with Serbia, Kosovo saw a massive loss of life, approximately 13,000 individuals, and wide spread displacement (Domanovic, 2014). This displacement and loss of life shrank the Kosovo population noticeably. Having an adverse effect on the Kosovan economy.

Coming from Serbia and the former Yugoslavia, Kosovo has no experience as a democracy. Despite Yugoslavia's unique approach to communism, it was a centralized communist state. Following the collapse of Yugoslavia, Slobodan Milosevic was president of Serbia, which also was a highly centralized government. Kosovo held its first democratic elections in 2013, meaning that Kosovo's democracy is only in its infancy and is still very fragile ibid. Additionally, Kosovo is only recognized by 110 countries in the world ibid. Its independence from Serbia is still debated and while Serbia has begun to normalize relations with Kosovo it is still a very politically sensitive issue. Countries with ethnic minorities and secessionist movements do not recognize Kosovo for fears of losing control on territories populated by ethnic minorities.

The Kosovo population is very young where individuals 18 years old and younger account for a remarkable 46% of the population., 55% of the population lives in rural areas. Of this group of people, 60% have no formal qualifications or skills (Osmani 2013). These rural areas are remote and spread out all over Kosovo. There are considerably more entrants to the labor market than there are jobs, resulting in individuals remaining and working on family farms. These family farms are non-factors in terms of economic growth. The yields from these farms are primarily for self-consumption. The overwhelming majority, 87% of farms, use exclusively family labor (Osmani 2013). The average size of an agricultural family is six members where the average age of the adult members is 39 years old. Kosovane families are large extended networks of households. The head of household male has an average age of 52, and only 8.5% of them possess a university of secondary education degree (Osmani 2013).

Households have various sources of income in the rural areas ranging from the sale of agricultural products to wage labor and remittances (See Figure 1). When these households were surveyed and asked to rank the potential factors that would contribute to setting up businesses or self-employment the top three reasons were to improve living standards, use the household's economic activity in a more productive way, and the prestige of running their own business (See Figure 2). When surveyed to rank the reasons why they are not engaged in self-employment the insufficient amount of capital, credits, contacts, and remoteness were cited as the top reasons (See Figure 3) (Osmani 2013). Moreover, when asked to rank the barriers to engaging in non-agricultural wage employment households ranked regional unemployment, low wages, lacking contacts, and remoteness as the top reasons (See Figure 4). The major takeaway from the survey is that a large amount of those engaged in agricultural labor are because they are pushed into the sector. Few respondents expressed a preference for agricultural labor. Moreover, a desire to generate more income to invest in agriculture is not a motivation for individuals to enter self-employment or wage labor. If macroeconomic conditions improve, the flow of labor out of the agricultural sector would be substantial (Osmani 2013).

The Kosovane economy is incredibly reliant on remittances sent from family members who are living and work abroad. Domestic economic activity is financed through these remittances are a vital lifeline of any consumption in Kosovo. It is estimated that about 800,000 Kosovars live abroad and send money back to their families in Kosovo (International Organization for Migration, 2012). The gross domestic profit per capita of Kosovo in 2016 was 3,661 USD but that does not accurately describe living conditions in Kosovo as it does not consider remittances sent abroad (World Bank, 2017a). The value of the remittances cannot be fully guaranteed as remittances are sent through unofficial channels outside of the banking system (Demi 2017). It is estimated that the yearly income of from the diaspora is approximately 1.5 billion euros (Morina 2017). That is roughly 22% of the value of the Kosovo economy. What is important to consider is that as the economic conditions of Kosovo improve the reliance on remittances will wane and family members abroad will stop sending remittances back to Kosovo.

Current Policies and Strategy

The Kosovo Investment and Enterprise Support Agency (KIESA) is tasked with promoting and welcoming foreign investment to Kosovo (ITA 2017a). The agency is strictly concerned with inflows as opposed to outflows and has no incentivization for outflow investment. An asset is considered a foreign investment if a foreign investor owns 10% or more of the capital of an enterprise. Kosovo has seen a steady decline in the percentage of GDP that FDI takes up (See Figure 5). While this could be encouraging as it could suggest the growth of the economy and FDI taking up a smaller percentage. Unfortunately, it is because the amount of investment has also decreased overtime. In 2007 FDI was valued at 600 million euro, in 2016 it had dropped to 250 million euro (See Figures 6) (World Bank 2017a). The decline of inflows suggests that foreign investors have become pessimistic of the domestic business climate in Kosovo and are now unsure of investing in Kosovo.

Current FDI flows are concentrated in three sectors, the financial sector, construction and real estate. Construction and real estate FDI is believed to be because of the efforts to privatize state owned assets. When examining the data on the makeup of these enterprises there is a caveat that needs to be understood there are a total of 4,295 foreign enterprises but, 4032 are considered “micro” enterprises consisting of 1-9 employees. This is because many enterprises have only one registered employee because 1,574 of these cases are still on the market research or business analysis stage in their business development. Taking this into account there are only 2,721 operational foreign enterprises with "micro" firms still consisting of over 90% of the enterprises (See Figure 7) (Hajrizi 2013).

Investment comes mainly from industrialized or developed countries such as Switzerland, Germany and the United Kingdom but there are also substantial flows from Turkey (See figure 8) (Halil 2017). What is encouraging to see is Albania also investments in Kosovo as regional cooperation is important to creating a dynamic economy. Albanian investment is not surprising given the demographics and history between the two countries but Albania who also struggles with capital investing in other countries demonstrates a regional willingness to invest. Kosovo has implemented a variety of programs to further investment foreign investment. These programs vary in creating preferential access and treatment for businesses and taking part in various initiatives, all aimed and attracting foreign capital.

Privatization

Since the early 2000s the GOK (Government of Kosovo) has been attempting to privatize industry. The Privatization Agency of Kosovo (PAK) oversees the privatization of public assets. State owned assets are diverse and include ownership in the agricultural sector, mining, minerals, and hospitality services. Potential investors whether they are foreign or domestic are all treated the same in the bidding process. Because there is a lack of capital in the country there is a chance that a sizeable portion of the state-owned enterprises (SOEs) will be bought by foreign investors (ITA 2017e).

In 2016 the Kosovane government adopted the "Law on Strategic Investment" in hopes of attracting foreign investment. The laws primary focus is to transfer ownership SOEs to strategic investors. What makes the law unique from other privatization schemes is that the law permits the GOK to directly negotiate with potential investors without going through traditional bidding procedures in special cases. Normally when governments sell off public assets they must put out a request for bids and begin negotiating from the various bid proposals offered. This allows the government to quickly sell off assets to potential investors. This expedited process encourages business activity by removing the often-despised red tape of the public procurement process (ITA 2017e).

The primary asset that has transitioned to private use has been real estate. Much of this real estate has been sold below value. Additionally, this real estate is already constructed infrastructure and very little green field investment as come about from privatization. The profits form privatization has not been reinvested into the Kosovo economy and it is suspected that 559 million euro is held in offshore accounts (Halil 2017). Of course, this money needs to be reinvested properly, a sudden influx of money into economy could cause negative effects given the fragility of the economy.

Economic Zones

The GOK has established 3 economic zones(EZ) that are compliant with European Union and World Customs Organization standards. Of these zones there are 4 classifications of EZ, industrial park focused on heavy industry, business park focused on light industry and consists of office buildings, technology park concerned with research and development of technological goods and economic zones which reduce the cost of production of export goods. Kosovo has 3 business parks located in the municipalities of Mitrovica, Gjakove/Djakovica, and Drenas (Ministry of Foreign Affairs 2015). Their aim is to facilitate trade and export growth and has specific rules governing warehouses, good processing, good transit and free-trade (Ministry of Foreign Affairs 2015). Foreign firms are permitted to import production inputs for the manufacture of export goods without paying taxes or customs duties, a very advantageous deal for foreign firms that have to import production inputs. Of these however only Mitrovica has completed the necessary legal and administrative procedures for building infrastructure. There have been other initiatives to establish other special economic zones across the country (Ministry of Foreign Affairs 2015):

- Industrial zone- Suhareka
- Dutch industrial Park -Prizern
- Business Park- Vushtrri
- Technology Park- Shtime
- Economic Zone- Gjilan/Kamernica
- Economic Zone- Ferizaj

Initiatives with International Actors

Kosovo has been working with the World Bank to further develop the Kosovo Economy. In 2017 it was ranked as the 40th in ease of doing business only 6 spots behind Japan. This jump has been credited to a lower administrative burden put on businesses. Growth in Kosovo has primarily been driven by consumption, remittances, and foreign aid. The World Bank’s new strategy focuses on various areas of improvement. The first is to create a stronger financial system and promote financial stability in the country to make capital more available for the local economy. Secondly, the World Bank is promoting policy reforms to encourage higher quality FDI that will provide more beneficial spillovers for the local economy. Thirdly, the "Competitiveness and Export Readiness project" is focused on developing a stronger and more developed export industry. A very crucial part of the initiative is to create a more reliable energy supply. This is a massive hurdle and needs to be addressed to promote economic growth. The initiative looks to promote energy efficiency, renewable energy, integration into regional power markets, and support for new power generation (World Bank 2017b).

Kosovo in 2015 signed onto the European Unions's (EU) Stabilization and Association Agreement (SAA). The agreement is focused on bringing the EU and Kosovo closer together to promote sustainable economic growth in Kosovo. The SAA creates a free trade area between Kosovo and the EU with EU standards and laws being applied in the country (Council of the EU, 2015). There are other provisions in the agreement such as cooperation in employment, energy and education. The agreement does not only improve conditions on the ground but can also improve perception of the country. If foreign investors see Kosovo as a legitimate country cooperating with the EU in various sectors, businesses will be more comfortable and confident in investing in the country (Council of the EU, 2015).

In addition to signing the SAA, Kosovo is a participant in an EU initiative to create a Western Balkan Regional Economic Area, other participants include Albania, Bosnia, Macedonia, Montenegro and Serbia. Its primary purpose is to create a free movement area where goods and services can move freely throughout, very similar to the EU common market. The aim is to deepen economic integration in the region with the ultimate hope of EU membership. While the European Commission endorses the plan and has said it is willing to assist it is ultimately up to the countries themselves to implement and regulate. For investment, participants have agreed to create a regional investment agenda focused on exchanging information and the best practices on investment policies. Ideally this will lead to a harmonization of investment policies across the area. There is a focus to stimulate private sector growth to maximize potential gains from the economic agreement (European Commission 2017).

More integration across the region will make it more attractive and competitive. The Balkan market would be 20 million consumers who have remained untouched by current economic activity. This will encourage more FDI which will create jobs and economic growth. EU and Balkan companies would be able to work closer together and develop relationships or supply chains. This integration would be incredibly beneficial for the Balkans and Kosovo specifically as they reform their institutions and develop their economies in hope of EU membership. What the SAA and Regional Economic Area do that will attract more foreign investment is it makes the Kosovo economy bigger. Kosovo has a smaller population which discourages investment due to a small consumer pool. With these two agreements the Kosovo market becomes much bigger and makes it a much more attractive place it invest due to its new market access.

Domestic policies & Taxes

All legal, regulatory and accounting systems are created in line with EU standards and laws. In 2016 he GOK created the Credit Guarantee Fund to improve access to credit in Kosovo where credit and capital are scarce. For companies investing in the country some companies can be granted certain value added tax (VAT) related privileges such as a 6-month deferment for companies importing capital goods. Additionally, suppliers can export without collecting VAT from buyers, resulting in lower prices for consumers. There are no over the top requirements that inhibit the movement of foreign investors or staff of companies. The GOK does not mandate local employment for foreign investors and investment incentives of domestic firms can also apply to foreign investors in certain cases. Investors also do not have to pay a customs duty or a tax on dividends (ITA 2017b).

Within Kosovo there are two companies that provide investment insurance. The Multilateral Investment Guarantee Agency (MIGA) insures investments up to 20 million euro. OPIC is a private company from the United States that provides political risk insurance specifically for foreign investors in Kosovo (ITA 2017f). Municipalities in Kosovo can lease moveable and immovable land to foreign investors on 10-year contracts. What is the most attractive part of Kosovo for foreign investment is that its corporate tax rate is only 10%, 2.5% lower than Ireland which is labeled a corporate tax heaven. Businesses investing in Kosovo will be able to keep substantial amounts of their profit (Ministry of Foreign Affairs 2015).

Alternatives and Recommendations

Kosovo has taken important and positive steps toward making Kosovo a more favorable destination for foreign investment. With that that there are still a variety of possible policy activities to further encourage the inflow of foreign capital. Some of the policies are more intensive than others but the more intensive the reform the more successful it will be.

Potential sectors of investment

Certain sectors of the Kosovo economy lend themselves very nicely to international financing and investment. Because of the lack of available credit for domestic actors to establish businesses of their own several sectors of the economy are open for more competition and business. Foreign investors will see excellent returns on their investment as they will be one of the potentially few firms in the sector.

<u>Energy</u>

Energy in Kosovo is produced in thermal power plants burning coal. There is only one firm in the energy market, The Kosovo Energy Corporation J.S.C (KEK). KEK was privatized in 2012 and purchased by Calik Holding & Limak from Turkey. KEK was a part of the bundled state-owned energy apparatus which has been slowly liberalizing. Local energy is produced from two power plants, Kosova A and Kosova B. The two of these plants account for 97% of the energy produced in 2015. Hydropower is also used in the country but is much more limited in scale. There are two problems with the energy sector in Kosovo, the high level of technical and commercial losses and the insufficient amount of energy produced. This is particularly problematic as the demand for electricity increases. Investments are needed in the sector with great potential. If a foreign investor can establish a more efficient use of energy or reform existing energy usage returns on the investment would be worthwhile given the demand for energy (KPMG 2017).

<u>Agriculture</u>

The privatization of agriculture has led to a decline in arable land and irrigation which has lowered agricultural output. Moreover, the farm structure of supply chains and moving crops from farms to merchants is fragmented. About 53% of the land in Kosovo is considered arable. There are many opportunities for farming and marketing of agricultural products. It has so far received very limited investment and anyone who moves into the sector will immediately be a major player in the market and will be able to strategically position themselves as an early mover for years to come. The agricultural system of Kosovo requires modernization and outside investment to become a productive sector in the economy. Better technology and business acumen in this sector is vital to its success. It is estimated that 140,000- 150,000 people are employed in the agriculture sector. Further development and investment in agriculture will to other opportunities in the food processing, horticulture and livestock (KPMG 2017).

Tourism

Kosovo is endowed with beautiful mountains, lakes and rivers. Kosovo's geography provides for several potential tourist ventures. The mountains to the south offer an excellent opportunity for winter tourism, specifically in the Mountains of Sharr and the Cursed Mountains. Here Brezovica and Rugova are ideal locations for skiing and other recreational activities. In April 2015, Kosovo's Trade and Industry Ministry signed a contract with a French consortium on international and local companies for the development of Brezovica. The investment is valued around 410 million euro and will be spent over the next 17 years. The goal is to make it the biggest mountain resort in the Balkans. Companies see the potential value in Kosovo and are taking advantage of opportunities. There remain excellent opportunities for investment in the numerous thermal springs in the region, the most famous springs are in Kllokoti and Peja. In addition, to these possible avenues for investment there are also plenty of religious and cultural historical sites that could develop into tourist stops (KPMG 2017).

Banking and Finance

The banking system in Kosovo is very diverse and consists of commercial banks, branches of foreign banks, microfinance institutions, non-banking financial institutions, foreign exchange officers and money transfer agencies. A Kosovo bank must be established in the legal form of a joint-stock company issuing shares with a fully paid-up minimum registered capital of seven million euro. Banks must receive a bank licenses issued carried out by the Central Bank of Kosovo before conducting operations, this also applies to foreign banks. There are ten banks operating in Kosovo: Bank for Business, Banka Kombetare, Tregtare- Kosovo Branch, Economic Bank, Komercijalna Banka ad Beograd- Mitrovica Branch, NLB Prishtina, Procredit Bank, Raiffeisen Bank, Turkiye Is Bankasi, Turkiye Cumhuriyeti Ziraat Bankasi A.S. Kosovo Branch and TEB SH.A. Foreign banks dominate the banking market. But there is still room for competition as access to credit is still difficult for pockets of the Kosovo population. Interest rates remain high because of the lack of capital in the region, more competition among banks will help bring down interest rates (KPMG 2017).

Telecommunications and Post

Kosovo Telecom (KT) J.S.C. provides multiple service in mobile and fixed telephone services, it also provides internet and TV services. KT has approximately 2,400 employees and the Republic of Kosovo owns 100% of its shares. In 2014 and 2015 KT invested more than 100 million euro in upgrading its network from 3G to 4G, one million customers benefitted from this investment. In 2008, Z-Mobile entered the market and begun providing telecommunication services. IPKO Telecommunications LLC (IPKO) a subsidiary of Telekom Slovenia is one the main companies in the information technology and communication sector and offers services in mobile communications, fixed telephony, digital cable television, internet services and media. It was the first operator to offer 3.75G network speed in Kosovo. Kujtesa Net LTD is an internet services and cable TV provider also located in Kosovo and is considered the third largest provider in the country. Postal services are provided by Post Kosovo J.S.C. and publicly owned company. There are several international companies operating in Kosovo such as UPS, TNT, Fedex and DHL. There is great potential in telecommunications and information technology for foreign investors to provide financing or start new enterprises in this sector (KPMG 2017).

Human Capital and Infrastructure provisions

The Kosovo population is a very young and dynamic potential workforce, but it's a very inexperienced work force. Foreign firms are attracted by the low labor costs of the labor market but are not excited about the potential costs of training employees to firm standards (Halil 2017). Further investment in human capital will not only encourage firms to invest it will also create a more dynamic society on whole. Kosovo is still lacking a large interconnected road system and buildings for business use. Poor roads are credited for the decrease of trade between Macedonia and Kosovo in 2015 as trade between the two countries dropped 200 million euro (Marusic 2016). Poor roads force businesses and individuals to find other places to purchase goods or invest. A foreign firm is not going to invest somewhere where there is a possibility that potential consumers cannot even get to. Foreign investors are encouraged by road links with Serbia and other construction provisions connecting roads to Macedonia, Albania and Montenegro (Hajrizi 2013). As basic as it sounds, further construction of roads and highways will allow for better and more efficient movement throughout the country. This will allow not only foreign firms that may have investments throughout the country stay connected, it will also help domestic businesses establish more efficient supply chains and expand their consumer base. Kosovo needs to become more connected and less remote.

Tailoring Policies for specific industries

Some investments are more positive for the economy than others. Foreign investment is vital to developing countries because of the possible spillover effects it can have on the economy. Some investments are more effective at creating spillovers than others. Investment in construction creates temporary employment for those hired for projects but what is created allows for the potential of additional growth. Investment in banks will allow for a stronger banking sector which will be able to create money through lending which can then be used by domestic actors to buy houses, start or expand businesses or invest. Foreign investment in the energy sector while beneficial may not be as useful for the local economy of Kosovo because the foreign firm may treat their investment as an extractive venture where resources are being removed from Kosovo. Foreign investment in manufacturing would be positive and generate long term growth. Manufacturing plants require construction of the plant, labor to perform tasks and management to oversee operations. The jobs provided will allow for labor to collect wages which can be spent in domestic markets further generating growth or save for future investments. The business itself will also spend money or take out loans to update technology or expand operation. Encouraging foreign investment in specific sectors can help the economy grow in a more dynamic way where a larger multiplier effect can be seen in the economy.

Reforms

The most substantial and important thing the GOK can do to promote more foreign investment is to reform institutions and policies. The government has tried to institute reforms to improve its democratic capacity, but there is room for improvement. How democracies are supposed to look, and function is still missing from Kosovo's government. On March 21st in 2018 opposition lawmakers released tear gas into the parliamentary chamber to prevent a vote ratifying a border agreement with Montenegro (CNN). This is not how governments should behave, especially in democratic governments. These incidents present Kosovo in a negative light making it look like unstable place. Investors will not want to invest in a country when its parliament cannot even have a simple vote. Additionally, there is wide spread corruption in the public procurement process creating an unfair competition where contracts are not being awarded to the most deserving bid. Many investors perceive the Kosovo market as having unfair competition with the government protecting certain industries (Hajrizi 2013). Foreign investors do not want to compete against subsidized or preferred industry, they want free fair competition where all firms are treated equally by institutions and the law.

Reducing corruption is not enough. When corruption is reduced good governments can significantly improve their economic growth (Weber 2018). Kosovo must first create a good government. Another glaring problem is the political situation. Kosovo has been ravaged by conflict and is still recovering from its past. The narrative must change, and Kosovo needs to begin developing a functional democracy. The country still has not moved on from its Albanian-Serbian cleavage which scares foreign investors due to the instability in the region and institutions. The recent assassination of Oliver Ivanovic a Kosovo Serb shows that the country has not fully healed (BBC 2018). Moreover, those in government are not true public administrators. President Thaci and Prime Minister Haradinaj are do not have backgrounds in public administration or democratic party systems. Businesses still hold concerns regarding the rule of law and if contracts will be enforced and protected. This alone is the biggest concern for foreign investors who fear that investments will be not be protected (Hajrizi 2013).

The first institution to reform would be the judicial system in Kosovo. There have been some successes in reforming the Kosovane justice system. The interethnic strife remains a huge issue but has decreased overtime. Kosovo has attempted to create a multi-ethnic judicial system and has a done well creating a multiethnic police force (Wilson 2006). It has not however been effective in creating a diverse judiciary. A multiethnic justice system is key creating an equitable application of the law, improving rule of law overtime. A homogenous judiciary will be perceived as having biases and not being truly impartial, a vital and important characteristic of courts. If courts and the judiciary system can improve the way it functions and is perceived, overtime foreign investors will have faith in the judiciaries ability to protect investments from other government institutions or domestic crimes.

What makes the process of reforming institutions so difficult is that institutions are considered sticky. Institutions are born from the activities and behaviors or individuals in a society. Over time these customs develop into a path dependency and society from there on out operates in that way (Boettke 2008). This applies to not only governments but also markets and micro level human behavior like a hand shake. The ultimate goal of institutional reforms is to create new customs and norms that eventually be locked-in and will lead to a new path dependency. The citizens of Kosovo want a democracy free of corruption and a functioning market system governed by prices. The problem is Kosovo does not have the path dependency of these institutions. Despite Yugoslavia's decentralized mode of governance Kosovo developed under a communist framework. It is not use to democratic systems and market systems. Kosovo's independence in 2008 opened the door for the country to transition to a more western societal construction. With this comes new customs, norms and laws that Kosovanes had never experienced before. Moving away from corrupt institutions is difficult because that is how institutions use to operate for decades in Kosovo and simply changing them overnight takes time. The sticky institutions in Kosovo are those of corruption and changing a norm is a very difficult thing to do. Unlocking the institutions of Kosovo and replacing them with fully functioning ones will take time. While foreign assistance is helpful in achieving development goals, ultimately the reforms and changes cannot be started from outside Kosovo, they need to internal. Kosovo citizens most be making the reforms and changing the way things are conducted to properly reform institutions (Boettke 2008).

Conclusion

Kosovo has the potential to be a functioning market economy where citizens have good standards of living and can lead productive fulfilling lives. Foreign direct investment can help alleviate the problems of poor training, lack of capital and lack of opportunity. It's young labor force provides foreign investors with an ambitious and optimistic work force. It's location in the Western provides firms in Kosovo with an excellent access to the European and Balkan market. Citizens have every reason to be optimistic about the future. Kosovo has various industries where foreign firms can invest and see respectable returns of their investments. Investment currently flows from countries in western Europe, in the Balkans and Turkey. The government of Kosovo has taken steps to encourage foreign investment flows to help develop its economy. What gets in the way of Kosovo realizing its potential are corrupt government institutions. Reforming institutions is difficult especially given Kosovo's the lack of path dependency with democratic institutions. If Kosovo is able to reform its institutions and change the image of its government, foreign investment will begin to flow into the country and the Kosovo economy will begin to grow.

Appendix

Figure 1- Breakdown of Kosovane Family Incomes

Source of Income	Percentage of Total Household income
Sale of Agricultural Goods	27%
Self-Employment	27%
Non-Farm Wage Employment	16%
Remittances	21%
Government Transfers	3%

(Osmani 2013)

Figure 2 -Importance of Potential factors motivating setting up a business/self-employment

(Means scores, 1= Not Important, 5= Important)

Reason	Score
Improve household living standards	4.37
Use household's economic activity in the most effective/productive way	4.00
Prestige of running own business, increased independence	4.00
Identification of market opportunity	3.63
To invest available capital	3.21
To generate income to invest in agriculture	3.11
Lack of on-farm employment	2.79
To invest in remittances received	2.50

(Osmani 2013)

Figure 3- Reasons for a Lack of Engagement in Self-Employment

(Means scores, 1= Not Important, 5= Important)

Reason	Score
Insufficient availability of capital	3.70
Insufficient availability of credit	3.50
Lack of proper contacts (connections)	3.43
Lack of demand/remoteness	3.33
Too many competitors	3.28
Insufficient information on starting a business	3.20
Insufficient knowledge or skills	2.99
House members prefer agricultural work	2.77
Household income is sufficient/ no economic pressure	2.76
Insufficient Time	2.50

(Osmani 2013)

Figure 4- Barriers to engaging in non-agricultural wage employment

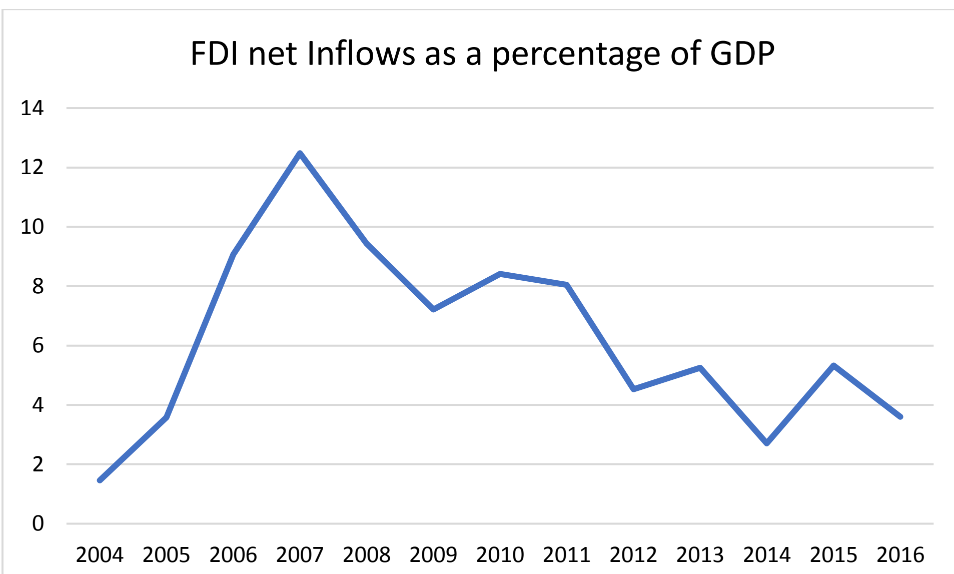
(Means scores, 1= Not Important, 5= Important)

Reason	Score
High regional unemployment	3.73
Low wages	3.68
Lack of proper contacts (connections)	3.41

Remoteness	3.38
Insufficient information	3.07
Insufficient knowledge or skills	3.07
Insufficient time	2.95
Household members prefer agricultural work	2.90
High age	2.50
Household income is sufficient/no economic pressure.	2.49

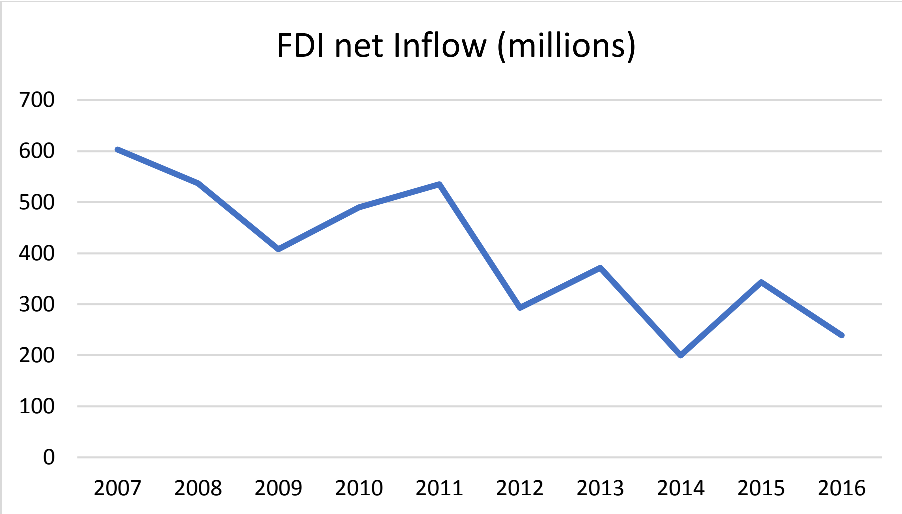
(Osmani 2013)

Figure 5-Foreign Direct Investment inflows as a percentage of GDP



(World Bank 2017a)

Figure 6- Foreign Direct Investment (in millions of $USD)



(World Bank 2017a)

Figure 7- Size of Foreign Enterprises in Kosovo

Size of Enterprise	**Number of Employees**	**Number of Enterprise**
Micro	1-9	4032
Small	10-49	199
Medium	50-249	46
Large	Over 250	18

*****1574 enterprises only have one employee and are still on the market research or business analysis phase. (Hajrizi 2013)

Figure 8- Foreign Direct investment partners -2016 Top five Countries

Country	Amount- Millions of EURO
Switzerland	62
Turkey	35
United Kingdom	33
Germany	29
Albania	29

(Halil 2017)

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