

## The Impact of FDI on the Economic Transition and Economic Development in Kosovo

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### Abstract

Direct foreign investment represents the commitment of cash in order to gain interest rates abroad to investors, so these investments affect the economic development of the country where the investment besides the material benefits, the country benefits also on the development of human resources and contribute to development of the country's manufacturing sector. These investments are according to economic theory and practice preferred to develop in countries which are in the process of development compared to those in countries where economic development is enormous. Through this work I filed theoretical analysis of matter, bringing theoretical aspects through descriptive method, analytic, and then bring research materials and reports concerning the matter making more enriched analysis graphically and analytically.

**Keywords:** investment, loans, transition, development, resources, financial resources

### 1. Introduction

FDI represent the commitment of monetary financial assets of a natural or legal person in another state that is not the seat or business development center of investor (Matthew, 2004).

- FDI, is characteristic of countries in which the economy is in its first phase of development and the probability that they are the most profitable investment is greater. This kind of investments brings benefits to both biased, investors and the state of investment thus contributing to the creation of new jobs is considered the key issue for potential development.
- FDI can be made by a natural person who has sufficient funds and ideas about investing, a firm which has its headquarters in other countries and has great development potential and competitive in the national and international market or even a government another State macroeconomic policies are favorable to potential investors and economic stability are among the key points that FDI to be larger.
- FDI in Kosovo in 2007 reached the highest amount of investment which in the years that followed came to halt, and according to the analysis of expected that in the coming years has declined, although the global crisis and that of the Euro zone had no direct impact on the economy of Kosovo to the fact that our country was not a member of the financial markets and capital, the impact came indirectly hit countries that invest here, so doing that consistently FDI to decline.
- FDI, are the main source of capital growth in developed countries and less developed ones, because they constitute a set of technologies, new management techniques, diversity of products and various services, etc. , which together affect the total growth of all factors of production in the host country (Nuvavoot, 2009).

### 2. Methodology

This paper aims among other things to give answers to some questions that relate to the impact of FDI on economic transition and economic development of Kosovo. The main purpose of this paper is to analyze the current state of knowledge and the practical implementation of strategies of FDI in Kosovo. To realize this paper was reviewed literature of different authors and Albanian international regarding the matter and on the basis of their work on the analysis of strategies implemented in Kosovo today. During work is quantitative method of data collection, i.e. has become analytical data collection.

Another method used in this paper is descriptive method through which I described graphically and analytically foreign direct investment in the country and their impact on economic development.

The data on flows and stocks of FDI are taken from various publications Statistical Yearbook of International Investment and material OECD reports published by the World Bank. The breakdown by country of origin of the investment by industry, it is often based on different sources may have a different stock of FDI-based art.

$$fdi = \frac{FDI}{GDP}$$

$$gcf = \frac{GCF}{GDP} \text{ and}$$

$$nx = \frac{NX}{GDP}$$

Required formulas are the following:

$$\hat{Y}_t = \alpha + \beta_1 fdi_{t-1} + \beta_2 gcf_{t-1} + \beta_3 nx_{t-1} + \epsilon_t$$

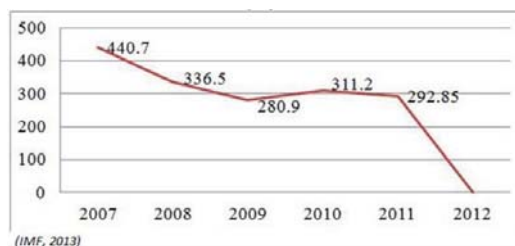
$$\hat{Y} = (GDP_t - GDP_{t-1}) / GDP_{t-1}$$

y represents GDP per capita and g is expressed as a linear function of all internal investments (GCF), FDI (FDI), increasing exports (nx).

### 3. Investment Rate and Rhythm of Foreign Direct Investment to Kosovo

Foreign direct investment FDI understood as a commitment of cash in order to gain interest rates abroad to investors, thus affecting the economic development of the country where the investment. Preferred FDI in the countries which are in the process of development than in those countries where economic development is enormous. Addition to material benefits, the country in which he earns investment in human resource development. FDI contributes to the development of the country's manufacturing sector. Currently the only option for economic development in Kosovo are foreign investment for the mere fact that domestic investment capacities are very limited (Domniku, Sokol; Selmanaj, Albina, 2013). Foreign direct investment started after 2000 while voluminous investments were made in the years 2007 - 2008. Major investments of the years from 2007 to 2008 dedicated to investing in the second mobile phone in Kosovo. The decline of foreign direct investment was recorded in late 2008 and early 2009 by the global economic crisis where foreign investment had decreased dramatically. However, 2010 - 2011 started investment growth, although at a much slower pace. These investments continue to be influenced by economic developments in the world namely the euro-zone. Euro zone economic crisis has had a direct impact on the size of investment in Kosovo, the reason is simply because as in the case of global crisis and in the euro zone, where potential foreign investors in their countries the crisis, then automatically falls the possibility and desire to invest in other countries, in this case in Kosovo. The only impact of the global crisis in Kosovo according to the IMF -That was the limitation of integration in global markets.

The following graph of the present through the first, the level of foreign direct investment in Kosovo.



**Graph 1** – Foreign direct investment during the years 2007 - 2012, according to International Monetary Fund (IMF)

In fact, FDI contribute to the economic development of countries in transition such as Kosovo.

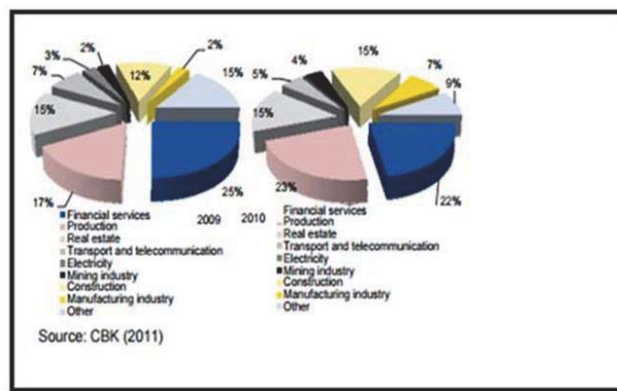
It is estimated that our country can benefit from these investments if:

1. FDI enables direct investments in projects that help the growth of the country

2. Reduce the cost in exchange of goods with international character
3. Stimulate, not to eliminate competition between domestic and international businesses.
4. Does not affect the unemployment situation, especially unskilled strata of the population.

Dynamics and volume of FDI has suffered increase and decrease in different periods. Especially, it is highlighted by the financial crisis in 2008. Various countries in the world have suffered or benefited in the ranking of FDI recipients - in the periods before and after the recent crisis. With 2008 global crisis, investment inflows fell to 1.7 trillion or 20%, while in 2009 to 1.1 trillion dollars, due to downward profit, bad credit conditions and reducing the value of the assets of enterprises. 2010 manifested an increase in FDI to 5% or 1.2 trillion dollars and in 2011 rose to 2%, the return of optimism.

Capital investment is the main category of FDI in Kosovo, followed by other investment category within the FDI. Capital investments represent 70.5 percent of total FDI in 2010 amounted to 221.8 million Euros (211.1 million euros in 2009). The category of other types of investments within the FDI consists mainly of loans between enterprises. This category of FDI in 2010 amounted to 49.5 million euro (23.2 million euro in 2009). The participation of other investments in total FDI in Kosovo was 15.9 percent in 2010. The significant participation in total FDI in Kosovo have also retained earnings of foreign companies operating in Kosovo. The level of retained earnings amounted to 43.4 million euro (57.2 million euro in 2009) and has a share of 13.8 percent of total FDI (CBK, FDI structure by economic activity).



In 2010 FDI structure by economic activity had some slight changes. Where featured product sector was with the highest sector received FDI (23.0 percent of total FDI). Important sector in attracting FDI is the financial sector with a share of 22.1 percent of total FDI. The investment of retained earnings from financial companies in Kosovo constitutes the bulk of these investments. Other important sectors for attracting FDI represent the sectors of real estate (15 percent of total FDI) and the sector of the construction industry (15 percent of total FDI). According to the source Business Registration in Kosovo in 2007 operated in 2000 foreign-owned companies and nausea and in the end of 2011 the number of foreign companies reached in 3906, the number of foreign investor's shows great potential and benefits which can be created in Kosovo on investment. To create a direct investment that the investor needs to have control over 10% of the total capital of the company which created, these investments are not based on the nationality of the investor or investment firm but the main headquarters of the investor or investment firm. That an investment firm in Kosovo comes as it must have sustainable competitive advantage and be able to survive in the market. Origin of foreign investors in Kosovo is mainly from EU countries FDI from Germany, UK, Switzerland, Macedonia, Austria and Slovenia. Investors Foreign biggest currently qualify: Raiffeisen, Vienna Insurance Group, Telekom Slovenia, Nova Ljubljanska Bank, BNP Paribas, etc. (CBK, some of the most internationally renowned businesses that have invested in Kosovo, 2012). Demands constant potential FDI are greater economic security, better legislation regulated and developed infrastructure. Currently as the biggest challenges are the management structures of revenue generation and creation of new jobs by domestic investors. Based on that it is a crucial management and adequate regulation of macro-factors in order to attract FDI - s.

FDI law provides legal protection to foreign investors so in many cases, even if it's a change of legislation or has civil armed conflicts that may adversely affect their assets then they have the right to seek compensation from the government .

**Table 1.** Foreign direct investment by country (years 2007- 2011 in million Euro)

State	Total	2007	2008	%Δ	2009	%Δ	2010	%Δ	2011	%Δ
<b>Total</b>	<b>18550</b>	<b>4408</b>	<b>3666</b>	<b>-16.8%</b>	<b>2875</b>	<b>-21.6%</b>	<b>3659</b>	<b>27.3%</b>	<b>3952</b>	<b>8.0%</b>
1 Germany	325.4	181	140.7	-22.5%	100.9	-28.4%	91.5	-8.3%	65.6	-27.2%
2 England	278.0	151	116.2	-22.4%	62	-47.4%	38.9	-37.7%	15	-61.5%
3 Slovenia	201.5	111	56.2	-49.3%	50.8	-11.2%	34.0	-13.3%	16.2	-52.4%
4 Austria	142.9	89	35.4	-60.3%	15.5	-56.8%	8	-48.4%	8	-7.1%
5 Switzerland	130.5	79	2.79	-96.6%	21.7	-72.6%	35.1	60.3%	7	-12.0%
6 Netherland	107.5	61	41.2	-32.5%	15.1	-61.1%	14.5	-4.7%	7	-51.7%
7 Turkey	83.3	49	5.4	-88.8%	14.5	-70.7%	4.9	-66.2%	4	-19.0%
8 Albania	80.1	3.4	0.89	-73.5%	23.3	580.0%	20.3	-13.3%	11.2	-44.8%
9 Others	505.8	279	90.0	-68.1%	8.19	-97.0%	4.9	-40.0%	14.89	200.0%

**Source:** CBK (Strategy of the Ministry of Trade and Industry to Private Sector Development 2013)

The table shows the trend of FDI flow in Kosovo by different countries where Germany leads, followed by England, Slovenia, Austria, Switzerland, Netherlands, Turkey, Albania and others. Taking the last three years, foreign direct investment was concentrated mainly in construction and real estate, followed by manufacturing and financial services. While in 2007 and 2008 the largest concentration of FDI was in the Transport and Telecommunications as well as financial services where the influx of FDI amount was up to 51.1% of total FDI by sectors of the economy.

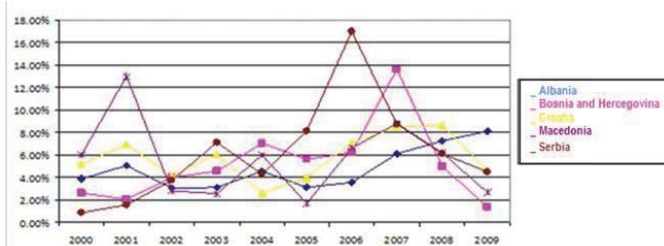
**Table 2.** Foreign direct investment by economic activity (years 2007- 2011, in millions of Euros)

Investments	Total	2007	2008	%Δ	2009	%Δ	2010	%Δ	2011	%Δ
<b>Total</b>	<b>18550</b>	<b>4408</b>	<b>3666</b>	<b>-16.8%</b>	<b>2875</b>	<b>-21.6%</b>	<b>3659</b>	<b>27.3%</b>	<b>3952</b>	<b>8.0%</b>
1 Financial services	393.5	212.8	127.9	-40.4%	73.3	-42.9%	43.2	-40.5%	47.4	1.6
2 Building	312.1	16.8	5.3	-68.4%	12.0	-77.6%	15.1	25.0%	15.1	43.0
3 Manufacturing	304.3	16.4	39.7	141.5%	17.1	3.0%	11	-35.7%	11	-68.0
4 Real estates	272.4	14.7	30.9	110.2%	14.9	-0.7%	8	-46.3%	8	50.1
5 Transport & Telecom	205.1	111.1	129.3	16.4%	7.4	-93.5%	7	-6.3%	7	-62.7
6 Mines	67.1	3.6	41.4	1033.3%	2.4	-94.2%	6	150.0%	6	-67.2
7 Others	301.2	16.2	92.6	472.8%	20.7	22.2%	4	-80.8%	4	142.4

**Source:** CBK (Strategy of the Ministry of Commerce and Industry Private Sector Development 2013-2017)

Regarding FDI in Kosovo in the form of investments, 73.2% are capital investments, which in September 2011 were approximately 22.0% higher compared with a year ago. In the context of FDI received in Kosovo, 14.2% are in the form of investments retained earnings, while other forms of investment (mainly composed of loans between enterprises) were 12.6% and have recorded a significant increase of 13,600. € 000 as compared with 2010 to € 36.9 million as of September 2011. Kosovo is not limited to the areas mentioned, but offers great opportunities for investment in other sectors, such as agriculture, energy, viticulture, tourism, mining and metal processing, etc. Also, the system of business registration in Kosovo is another important factor in the growth of investment incentives, simplified procedures and the registration of new businesses for a short period

Kosovo is working on creating financial capital market, in which investors will find opportunities to invest in shares of other companies.



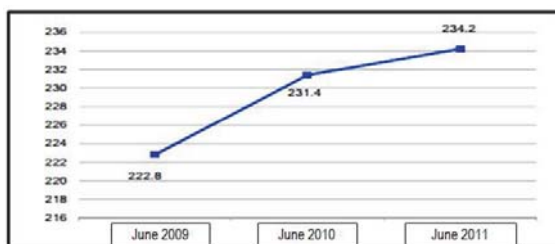
**Graph\_2.** The weight of FDI to GDP (%)

**Source:** World Bank

As can be seen from the chart, at the end of 2009, the share of foreign direct investment (FDI) to the gross domestic product (GDP) in Albania has been the highest in the region (8.1%), followed by Croatia (4.6%), Serbia (4.5%), Macedonia (2.7%), and Bosnia and Herzegovina (1.4%).

### 3.1 The impact of FDI in Kosovo, as an important part of economic transition

Great contribution to the economic development of Kosovo is considered to have the Kosovo's immigrants who possess investment potential and decide to focus on investment in Kosovo. The possibility to enter foreign direct investment from other countries come as a result of low economic development of Kosovo, tremendous market potential for the workforce as well as the need for consumption and as a result will have global economic integration Kosovo. However the need for Kosovo to FDI and the Diaspora does not promise that a sustainable economic development even though its financial system is sound, and there have been direct impact of the recent crisis. Remittances (remittances) in Kosovo Diaspora FDI increase consumption increases while construction activity (Domniku Sokol; Selmanaj, Albina, 2013).



**Graph\_3.** Deliveries of remittances in Kosovo

**Source:** CBK Financial stability report – December 2011 pg. 2

Due to the growth 2009 - 2011 is that the workforce of Kosovo are concentrated in Germany, Switzerland and Great Britain, which is outside the euro zone unlike Albania who are concentrated in Greece and Italy. The process that has had the greatest impact on attracting foreign direct investment has been the process of privatization and the CEFTA agreement which represents a further opportunity for investment even though Kosovo is part of its larger trade develops

with the EU member states - the. The best way to have economic development for Kosovo in the number of employees is the continuation of investment from abroad. These investments are considered as fresh capital, where it is known how and where to invest and create new jobs. Lack of circuits which will provide information on the business environment in Kosovo are many packages, as a result, there is great confidence by foreigners that Kosovo is a potential place for their investments. Another problem is thought to be legal protection for investors offered by the government. Providing favorable conditions for FDI will have a positive impact on further development at least until domestic investors to reach a stage of accumulation of their assets. FDI since 2007 account for about 9% of GDP - the (Gross Domestic Product), whereas 73.2% of these funds are capital investments, 14.2% investment in the form of retained earnings, and 12.6% are in other forms p.sh to loans by enterprises (Kosovo, March, 2012).

### 3.2 The reasons why they should invest in Kosovo - as a result of economic transition

FDI in Kosovo are necessary but which would be why foreign investors to invest here? Arguments about why to invest in Kosovo are many benefits to be apart of our country also having foreign investor's offers the possibility of promotion and development of their businesses, creating in large benefits. Kosovo Foreign investors offer:

- *The youngest population in Europe, where the average age is 25 years, high power skilled workforce, ready to work.*
- *€ euro official currency,*
- *Offers free access to EU markets - the USA - and CETA - the*
- *Lower taxes for economic activity where income is 0-10%,*
- *Contribution to income 5%,*
- *VAT 16% and tax on corporate income 10%,*
- *UNs Economic stability especially after 2008 with the declaration of independence, which continues to grow and is a member of the IMF - and World Bank, as well as the legal system in Kosovo since 1999 is built in accordance with EU legislation - the where foreign investors enjoy national treatment, it is considered as a strategic location for investment because in the center of the Balkans and also is experiencing great development of infrastructure and greatly possesses natural resources and agricultural land. Kosovo's banking system was not influenced by the global crisis and financial institutions are private and very healthy financially. From all this*
- Economic development of Kosovo can only say that it depends on whether there are investors willing to invest, to engage their monetary assets in our country. As a limiting factor affecting the penetration of the global financial crisis in Kosovo and Albania for reasons that do not operate with the so-called financial derivatives, but financial activity based on simple lending and keeping deposits thereby creating their profits. Kosovo economy, as an economy in transition has considerable economic progress but is still very dependent on the international community and the Diaspora for financial assistance as well as technical assistance. Its citizens are considered the most poor in Europe by GDP per capita; high unemployment is a serious problem for Kosovo, inter alia, to the fact that migration affects people and black market activity (IMF, 2011). Some analyzes made by the IMF foresaw that in 2011 and 2012 had economic development by 5%, what really happened that according to statistics published earlier this year claimed that economic growth for 2011 reached about 5% that was driven mainly from the private sector but it should not be overlooked that the prices rose significantly in response to inflation (IMF, 2011). In addition to attempting to argue this fact, we will present a SWOT analysis. As follows:

<p>Strengths</p> <ul style="list-style-type: none"> <li>• geographic proximity to most of the regions and markets in Europe</li> <li>• skilled workforce with a relatively low cost</li> <li>• Mineral resources</li> <li>• Natural and tourist attractions</li> </ul>	<p>Weaknesses</p> <ul style="list-style-type: none"> <li>• small domestic markets</li> <li>• The low per capita income</li> <li>• poor infrastructure</li> <li>• obsolete industrial technology</li> <li>• Financial Sector Weak</li> </ul>
<p>The possibilities</p> <ul style="list-style-type: none"> <li>• European Integration</li> <li>• wide Diaspora</li> <li>• Education System Reform</li> <li>• Rebuilding the Infrastructure</li> </ul>	<p>The Risks</p> <ul style="list-style-type: none"> <li>• Competition neighboring countries</li> <li>Increase in wages and loss of competitive advantage of low labor costs</li> </ul>



### 3.3 Obstacles that affect FDI in Kosovo

Slowness in implementing institutional reforms, construction and operation of democratic institutions, the presence of corruption, political risk and the lack of an efficient macroeconomic management in Southeast Europe (SEE) region have not considered attractive destination for foreign investors. All countries in the region lag far behind in comparison with the countries of Central Europe (CE) regarding FDI. Therefore, the withdrawal of FDI in Kosovo has also geographical limits, so things should be resolved at the regional level. On the other hand it is clear that attracting serious investors in each country of the region necessarily includes the regional dimension. Kosovo should also benefit from its central position in the region; it materialized gravitating attraction of investments in the region and beyond. However, because of the regional cooperation among numerous problems stagnate. Intra-regional trade in most countries ranges 9% and 10%, with the exception of Kosovo where it is over 60%. Whereas joint ventures between partners in the region are also very small. There are legal institutions such as Transparency International, which made the ranking of countries based on the level of corruption that have them places these institutions play a crucial role in the process of market-oriented development while protecting the privacy rights, particularly property and contract rights of foreign investors.

## 4. Conclusions and Recommendations

In the process of economic transition, over the years, especially in recent years, many countries, including those of central Europe, the EU countries and beyond, as is the case with the US:

First of all, many reasons, particularly the impact of the global financial crisis, according to the table 1 we can see a significant decline in the FDI in Kosovo, and that dropping significantly in percentage, e.g. United Kingdom of 116.2 immediately in 2008 decreased to FDI of 112.8 to 36.6 million, but as the markets which use this drop in Kosovo's ethnic FDI, whether the United Kingdom, with the rate falling slightly to Germany (about 4%), or France, we see an increase in FDI from neighboring Kosovo, e.g. Albania had 3.4. million, registered an increase in over 20%, or even Turkey from 5.4.% to 23. 4%, and so on.

But, generally, in the last three years, viz., after providing the latest statistics from the authorities, it appears that in Kosovo there was a decline of FDI in the last three years, then progressed i.e. 2007 - 2010.

Some recommendations:

- Be aware of the business community on the opportunities offered by foreign investment and a potential partnership in these investments.
- Social and political community work in providing safe conditions for investment and a stable legal environment and functional.
- Protection of loyal competition by reducing tax evasion and intensify the continuation of systematic anti-corruption measures;
- Facilities for export through the creation of Kosovo's trade identity and signature of agreements with neighboring countries and other countries to eliminate administrative obstacles, such as recognition of Kosovo origin certificate and adhering to the principle of reciprocity in trading relations.

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