



Balance of Power: Kosovo

Topic B: Economic Development in Kosovo

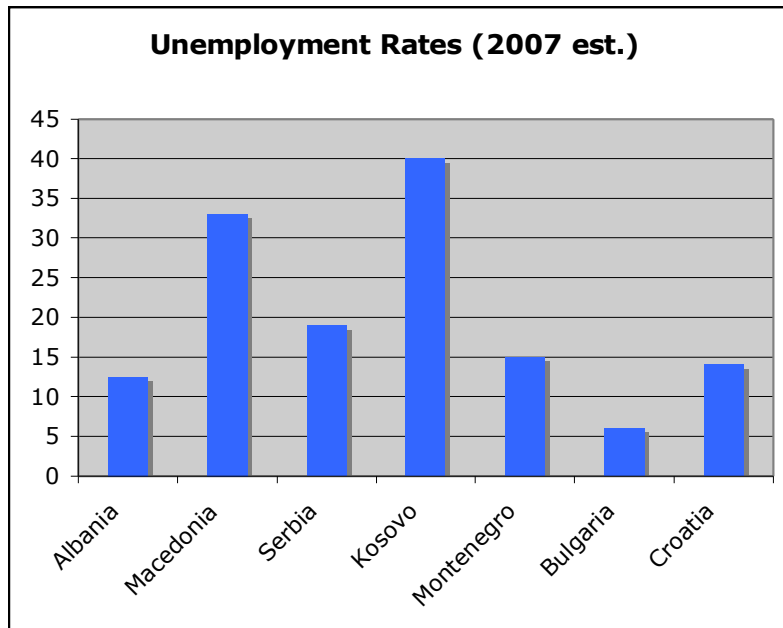
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Introduction

Having a stable and productive economy is an integral part of building an independent nation. Kosovo's economy was essentially decimated by the Kosovo War, and Kosovo is currently highly dependent on the international community and the diaspora for financial assistance; 15% of Kosovo's GDP comes in the form of remittances from the diaspora (mainly in Germany and Switzerland), and another 15% is from donor-financed activities. Kosovo's citizens are, on average, the poorest in Europe, with 44% of the population living under the poverty line. One major problem that plagues the economy is unemployment, which affects 40% of the labor force, drives Kosovo's severe "brain drain," and leaves an opening for black market activity. Kosovo currently has the highest unemployment rate in Europe, which threatens the stability of the nation.



*Data taken from the CIA World Factbook:
<https://www.cia.gov/library/publications/the-world-factbook/>*

Constant tensions between Albanians and Serbs in the north have proved detrimental for the investment climate in Kosovo. The continued shootings and bombings between the two groups have increased anxiety amongst officials who are afraid the tensions may spread and lead to political uncertainty in the nation. This uncertainty deters foreign investors, who are instrumental in spurring economic growth.

Another factor that needs to be addressed in the rebuilding of the Kosovar economy is the current lack of competition that resulted from the war. The combination of insufficient production levels, lack of investment, and inflated prices are detrimental to Kosovo's external trade relations. This underlies the giant trade balance deficit, which is further worsened by Kosovo's high consumption level.



Despite having such a high unemployment rate, the nation saw a governmental budget surplus, extensive privatization, and a sizable increase in pension revenues this year. The problem the Cabinet faces is determining the most effective way to allocate these resources for the greatest benefit to the economy. Three main possibilities for consideration are to allocate money to employment programs, to increase state exports, or to fund security enforcement programs to help promote peace between Albanians and Serbs.

According to Riinvest economist Alban Hashani, “If nothing improves in the next two years, there will be social unrest, from both those who have no jobs and those working in the public sector but are not paid well.” Thus, the Kosovar Cabinet should develop strategies towards building a sustainable economy for the nation. The boom in foreign investment that many expected to occur after Kosovo declared its independence has not yet happened. If Kosovo expects recognition as an independent state by multilateral organizations such as the United Nations, then it must first unite to develop a growing and stable economy.

Background

Historical Overview

Kosovo’s recent history makes clear the reasons for its current economic plight. In 1989, former Serbian president Slobodan Milosevic stripped Kosovo of economic self-determination and imposed centralized rule from Belgrade. Throughout the 1990s, international sanctions, weak access to external trade and finance, poor economic policies, and internal ethnic conflicts proved severely detrimental to the already weak economy of Kosovo.

The Kosovo War began in 1998, when Milosevic started a military campaign against the Kosovo Liberation Army (KLA) and forced over 800,000 ethnic Albanians from their homes. Consequently, the Rambouillet Accords were implemented and called for NATO troops to preserve peace in the region. However, Milosevic’s refusal to agree with the Rambouillet Accords led to a NATO military campaign that lasted from March to June of 1999. In 1999, the United Nations Interim Administration Mission in Kosovo (UNMIK) was formed and Security Resolution 1244 outlined a specific set of objectives for the initiative. However, the UNMIK is often criticized for



failing to implement an economic development strategy, despite the creation of the Economic Strategy and Project Identification Group (ESPIG).

Kosovo declared its independence on 17 February and committed itself to the Ahtisaari Plan, drafted by Marti Ahtisaari, the former president of Finland who was appointed to lead future status progress in Kosovo. In December 2008, the UNMIK passed many of its roles to members of the European Union Rule of Law Mission in Kosovo (EULEX) with troops from Germany, Italy, and the United Kingdom. In May and June 2009, the International Monetary Fund and the World Bank, respectively, voted to admit Kosovo as a full member. Additionally, the Ministry of Finance has recently produced a Medium Term Expenditures Framework (MTEF) for 2010-2012 that outlines strategic policy priorities of the government.



EULEX troops move into Kosovo's northern border to mark the switch from the UN to EU occupation. *Photo taken by Visar Kryezlu. 9 Dec 2008; <http://nimg.sulekha.com/Others/original700/kosovo-eulex-2008-12-9-7-33-25.jpg>*

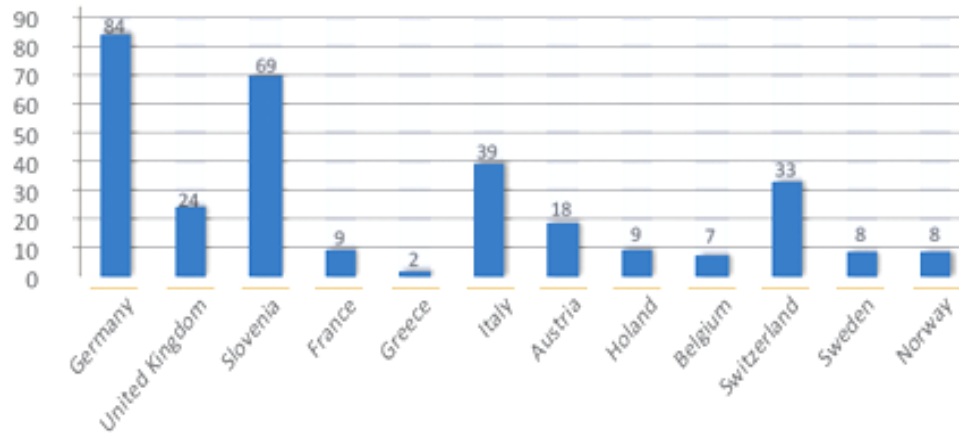
Steps Towards Regional and Global Integration

The Kosovar Cabinet must acknowledge that one of its ultimate goals should be to integrate itself as a major actor in the Balkan economy. In May 2009, the current Minister of Finance and Economy, Ahmet Shala, explained that the Cabinet has already taken a few steps towards future development of a liberal market system to foster a small open economy. First, they set up a Banking and Regulatory Authority to try to attract international banks and allow local banks the opportunity to develop; as a result, there are currently two banks with local ownership and five with foreign capital. Second, they implemented a complex privatization process that has led recently privatized companies to assume full operation and create new jobs.



As another step to reach out to global partners, the Government of Kosovo has been placing greater emphasis on Foreign Direct Investment (FDI) in the region. So far, Kosovo has attracted over a billion euros in FDI. There are currently over two thousand companies of foreign and mixed ownership that have already invested in Kosovo. Most FDI in Kosovo comes from firms based in Germany, Italy, Slovenia, and Switzerland. The Second Millennium Development Goals Report for Kosovo further recommends that Kosovo should create a more favorable environment for private sector developments that could then attract more foreign direct investments to work towards sustainable economic growth.

Foreign Investments in Kosovo - by country, 2000-2006 (million Euro)



ECIKS Investors' Guide; 2009.
http://www.eciks.org/english/publications/investing_in_kosovo/content/media/investorsguide_web.pdf

Various organizations are also helping Kosovo with its integration process by providing incentives for investment in the form of investment guarantees. The US Overseas Private Investment Corporation (OPIC) provides risk insurance for foreign investors, and the Multilateral Investment Guarantee Agency (a member of the World Bank Group) guarantees investments in Kosovo up to a value of 20 million euros. These guarantees help to attract potential investors from different nations by providing a safety net for their investments.

Trade

In order to promote an open and liberal market system, Kosovo recently joined the Central European Free Trade Agreement (CEFTA). CEFTA outlines three main objectives for its members: promotion of the development of economic relations and activity between parties,



provision of fair conditions of competition for trade, and removal of trade barriers to expand world trade. Kosovo also has customs-free access to the EU market, based on the EU Autonomous Trade Preference (ATP) Regime, and significant access to American markets.

However, with regards to trade, Kosovo is also struggling due to its nature as an imports-oriented country; in 2008, the value of Kosovo's imports was nearly ten times that of its exports. Ten years after the war, Kosovo's exports are still at a very low level as a share of GDP (less than 6% of GDP). Kosovo's exports were badly hit by the global economic crisis and have declined by more than 40% since November 2008. The International Monetary Fund (IMF) projects Kosovo's 2009 current account deficit to be 37% of its GDP, up from 30% in 2008. Kosovo must improve its trade balance in order to develop its economy, which relies on its money supply from the Balance of Payments accounts.

Current Situation

General Facts and Statistics

The Kosovar Cabinet currently faces a list of daunting statistics that they must work to improve in order to further stabilize the economy. Nearly 40% of the Kosovar labor force is without work. The World Bank estimated that about 15% of the population is living on less than one euro (1.35 USD) a day. Additionally, Kosovo relies heavily on foreign aid; it received an estimated \$324 million from other nations in 2007. Finally, Kosovo currently runs a trade balance deficit of over 40% of its GDP.

There is a bright side to contrast these grim numbers. Kosovo and Albania were the only two countries in the Western Balkans that experienced positive economic growth in 2009. The International Monetary Fund (IMF) estimated the economic growth of 2008 at 5.4%, which is higher than that of 2007 (3.9%). As of the end of 2008, exports have increased to 195.9 million euros, which is helping to narrow the trade balance deficit. The inflow of foreign direct investments is also rising. Profitable foreign investors include Vienna Insurance Group, Telekom Slovenia, and Nova Ljubljanska Banka. The government has managed to maintain a stable macroeconomic environment and financial management system and established a stabilization reserve separate from



the budget to monitor the liquidity situation. Additionally, Kosovo's adoption of the euro as its currency has led to increased credibility and stability of its financial system.

Currently the financial sector of Kosovo is defined by a two-tier banking system, consisting of the Central Banking Authority of Kosovo and eight private banks, ten insurance companies, and two pension schemes. One major driving force behind Kosovo's economic growth thus far is the Small and Medium Enterprises (SME) sector. With international assistance, Kosovo has privatized 50% of its socially owned enterprises (SOEs) by number and over 90% by value. The privatization of these SOEs has generated around \$563 million since 2004.

What's Being Done

In terms of measures to combat corruption, Kosovo has various specialized agencies, including the Financial Investigation Unit, which investigates white-collar crime and the misuse of public moneys. Additionally, the Financial Information Centre (FIC) monitors financial transactions by banks and other financial firms to help prevent money laundering. The Government of Kosovo has recently started developing its own Public Expenditure and Financial Assessment (PEFA) process to add to the audit-reporting systems that are already in place.

Conference on the economic crisis in the Western Balkans. <http://mef-rks.org/images/stories/lajme/mef-10.12.2009.gif>



As mentioned in the previous section, Kosovo is currently working on developing bilateral relationships with surrounding countries and attending multilateral conferences to discuss the global economic crisis as a whole and integrate themselves into the Balkan economic community. On 9 December 2009, Deputy Prime Minister Hajredin Kuqi and Minister Shala attended a conference discussing the economic crisis in the Western Balkan region. Kosovo is also a participant in the



Stabilization and Association Process (SAP), a policy framework passed by the European Union which has a tracking mechanism (STM) that guides and monitor's Kosovo's development with regards to the European Partnership. In addition, on July 11, 2008, representatives from 37 countries and 16 international organizations met in Brussels and pledged approximately \$1.9 billion to support socio-economic reform priorities in Kosovo.

With regards to the labor market in Kosovo, although the country's unemployment rate is the highest in Europe, there is great potential for the future. Currently, 70% of Kosovo's population is under the age of 35, giving it the youngest population in Europe. This younger generation provides much potential for the future of the Kosovar economy, but if the government is not careful, it could also prove detrimental by further increasing the unemployment rate as a greater proportion of this younger segment of the population moves into the labor force. Kosovo also currently has the lowest cost of labor in the region. While this makes wages in Kosovo competitive, the government should also consider the possibility that many highly skilled Kosovars may want to search for jobs outside of the nation in hopes of higher salary. Additionally, the 2010-2012 Medium Term Expenditures Framework (MTEF) observes that even if the economy could move to a permanent growth rate of 6% in the next fifteen years, unemployment will only have halved. The MTEF explains that the government must improve the current path of economic development so it will ensure better infrastructure, more jobs, and further development of domestic production and human capital.

Government Objectives and Concerns

The Kosovar government has targeted four goals they wish to work towards in order to develop the Kosovar economy: first, development and execution of a strategic plan for increased economic growth; second, formation and provision of a framework for good governance; third, allocation of resources to address poverty and social deprivation; fourth, implementation of the policies outlined by the Ahtisaari status settlement.

Although the global economic crisis has been relatively confined to developed countries, Kosovo faces significant risks if the recession continues. Macroeconomic projections already suggest a weakening growth dynamic in 2009. The 2010-2012 MTEF forecasts that there will be a



decline in both remittances and foreign direct investments. As a result, real GDP growth is predicted to decline by about 2 percentage points.

Outside Recommendations and Strategies

One major organization that is currently supporting economic development in Kosovo is the Economic Initiative for Kosovo. ECIKS is a non-profit organization that aims to develop economic policies and strategies for Kosovo. It has organized and executed a variety of different programs within the country such as Foreign Direct Investment (FDI) Promotion. ECIKS hopes that this particular program will help to create new jobs in Kosovo, bring in fresh capital, and reduce poverty through stimulating FDI. This program can work together with the Ministry of Trade and Industry in Kosovo and the World Bank to develop a national FDI strategy. The organization further outlines ten primary reasons that other nations should want to invest in the Kosovar economy:

1. Central location in the region
2. Young, educated, multilingual and dynamic population
3. Competitive, flexible, and well skilled labor force
4. Modern telecommunications: Kosovo has 3 fixed telephone operators, 2 mobile telephone operators, and three main internet service providers
5. Modern, EU-compatible legislation
6. Sound banking system: The Central Bank of the Republic of Kosovo acts as a financial supervisory agency and is responsible for licensing, ensuring the proper functioning of the payment system, and regulating and supervising financial intermediaries.
7. The euro as primary currency: eliminates currency and exchange rate risk
8. Free access to EU, US, and CEFTA markets: free trade in Kosovo leads to more export possibilities and a better investment environment
9. Great investment opportunities
10. Low tax burden and modern business support institutions: with a personal income tax of 0-10% and a corporate income tax of 10%. Organizations such as the Investment Promotion Agency of Kosovo (IPAK) offer a range of free services for foreign investors.

Other organizations such as the IMF have also started offering recommendations for areas in which Kosovo's economy could be improved. In the September 2009 report submitted by IMF, the organization suggested that efforts should be made to broaden the tax base through gains in tax administration. The report asserts that improvements in domestic tax collections would provide funding for sustainable expansion of social spending.



The United Nations Development Program (UNDP) has also taken steps towards promoting economic development in Kosovo. First, considering the fact that rural areas are home to 60% of Kosovo's population, UNDP has stressed the need to unite agricultural co-operatives and connect them with new markets to increase Kosovo's productivity. In addition, UNDP has highlighted the need to combat the problem of unemployment of youth, given that roughly 200,000 young people will reach working age in the next five years. UNDP has developed the Employment Generation Project that pays companies to employ first time workers for six months to help youths that face a disadvantage for being inexperienced.

Ministry Positions

Below are some descriptions of areas that specific ministries have been involved with over the past few years.

Ministry of Agriculture, Forestry, and Rural Development

Currently, 80% of Kosovo's agricultural land is privately owned and provides subsistence farming for individual households. The agricultural sector accounts for around 25% of Kosovo's overall GDP and provides a job for one out of every six Kosovars, making it the largest employment sector in Kosovo. On the trade front, agriculture accounts for 18% of total export value. The Government of Kosovo has recently introduced different incentives for farmers and processors. These incentives include a Value-Added Tax exemption for most agricultural inputs. With regards to forestry, forests make up around one third of Kosovo and provide between 50 and 75 million euros for the economy annually and jobs for one out of every ten Kosovars.

Ministry of Energy and Mining

The United States government is currently working with the Ministry for Energy and Mining and the World Bank to start a commercial tender and mining project to construct a new power plant and develop a coal mine for the New Kosovo plant and two existing power plants. In addition, the World Bank has identified the mining and energy sectors as potential key sources of future growth. The 2009 country brief suggests that utilization of lignite resources by attracting foreign investment could lead to further economic growth for the country.



Ministry of Trade and Industry

Minister Lutfi Zharku has expressed his strong support of the development of a Foreign Direct Investment policy for the nation to help create new jobs for the current labor force along with the 29,000 people who enter it annually. Also, as mentioned earlier, Kosovo should work towards a more balanced export-to-import ratio.

Ministry of Education, Science and Technology

There are currently thousands of students enrolled in universities in Kosovo who are soon to enter the labor market. The Ministry of Education, Science and Technology (MEST) should work to promote awareness of available jobs within Kosovo to these students. The Ministry should also raise government awareness of the sectors in which these students are trained so that the government can perhaps take steps to create more jobs in those sectors. Additionally, MEST should work on the grassroots level to increase enrollment in educational programs of all types and reduce the proportion of Kosovo's labor force that is unskilled.

Ministry of Transportation and Telecommunications

In terms of road infrastructure, there is currently a highway being built to connect Kosovo with Albania and Serbia, which would make Kosovo an important gateway between the Adriatic Sea and Western Europe. The construction of this highway led the Albanian government to grant Kosovo control over Port Shengjin, which will undoubtedly have a significant impact in economic development. However, the MTEF asserts that Kosovo should take even more steps to improve its transportation network by improving connections to Albania and Macedonia.

The telecommunications sector is dominated by the Post and Telecommunications of Kosovo (PTK). The IMF identifies PTK deposits as an important source of funding for the banking sector. In order to finance the current deficit, one option is to spend a prospective dividend payment from the PTK. If fully declared, the PTK dividend would roughly amount to around 150 million euros. However, this does come with a fair amount of risk of undermining macro stability and impacting the financial sector's level of liquidity.



Questions to Consider

1. What policies could be introduced to level out the trade balance deficit, which is currently at about 40% of Kosovo's GDP (1.8 billion euros)?
2. What additional resources can be utilized to develop the exports sector of Kosovo?
3. What steps should be taken to increase annual economic growth in Kosovo?
4. How can the Government of Kosovo increase the number of available job opportunities?
5. What can the Government of Kosovo do to increase and ensure fiscal sustainability despite the current global economic crisis?
6. What incentives can the Government of Kosovo provide to outside nations and organizations to encourage continued or new investment? What is the best way to promote awareness of these incentives?
7. What actions can the Government of Kosovo take to decrease the anxiety of investors who may be concerned with the effects of ongoing tensions between Albanians and Serbs in northern Kosovo?
8. How can Kosovo work to slowly wean itself off its reliance on international aid and remittances from the Kosovar diaspora?
9. What sectors should the Government of Kosovo focus on first in order to promote increased economic growth?
10. How can the Government of Kosovo improve the competitiveness of the economy to increase production levels and innovation?

Recommended Sources

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