

The main issues preventing Kosovo's economic development

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Abstract

This study provides an analysis of several problematic factors preventing Kosovo's economic development. Several sectors that could have been the main pillars of economic development, such as manufacturing, energy, mines and minerals, and other economic sectors have been neglected from the development by domestic institutions or were used clandestinely by certain interest groups, whose focus was not in the development of the country but rather their personal gain. Trade remained the preferred activity throughout these years, which cannot be considered a beneficial sector for economic development, as much as manufacturing, which remains to date as Kosovo's most underdeveloped sector. As long as Kosovo's exports cover only 12% of total imports, no economic growth can be expected. Kosovo's failure to attract strategic investors in years, which could open new jobs, has also contributed its lack of sufficient economic development. Thus, the most concerning issue during this period is the decline in foreign direct investments, which were expected to increase after the declaration of independence.

In the lack of a long-term development strategy for certain sectors or priority activities, such as mines, energy, industry etc., there is no progress in the country's economic development. The main issue is that we should only favor those activities or identify segments where we have competitive advantages compared to other countries.

Keywords: Economic issues, Kosovo's economy, FDI, Doing business, Strategic investors.

Introduction

In 2016 Kosovo's economy marked a higher activity compared to the previous year. According to the estimates of the Kosovo Agency of Statistics for the first three quarters of 2016, the nominal GDP value reached 4.25 billion Euros, which in real terms constitutes an average annual increase of 3.5%. The overall activity in the country was mainly driven by the increased domestic demand, whereas net exports had a negative impact in the economic growth rate. In terms domestic demand, the real growth of the country's economy in the first nine months of 2016 is estimated to be the result of increased consumption and private investments, whereas public consumption and public investments are estimated to have declined. The increase in bank lending and increased inflows of external transfers in the form of remittances and compensation of workers resulted in the increase of private consumption during the first nine months of 2016. In addition, the increase of public sector salaries and pensions in the country had a full effect in 2016, resulting in

increased available incomes in the economy. In the same period, higher FDI and new investment loans contributed to the strengthening of the private investment position. According to the manufacturing approach, the economic growth in 2016 was mainly a result of the value added growth of the activity in the construction, agricultural sector and electricity supply.

Within the industry sector, data of the industrial turnover index indicate a decline in the turnover in the extracting industry, and an increase in the processing industry sector turnover. In line with external market developments, particularly with the price level in the Eurozone and the Western Balkan countries, Kosovo's economy was also characterized by a rise in the level of daily consumer prices.

Unemployment rate

According to a publication of the Kosovo Agency of Statistics (KAS), two-thirds of the population in Kosovo consist of working-age, where the working-age population includes the ages between 15-64.

Within the working age population, the participation rate in the workforce is 40.2%. Economic sectors leading in employment continue to be: trade with 14.3%, construction with 12.8%, manufacturing with 12.7% and education with 10.4%. Whereas other sectors have a lower share in employment. The following is an overview of jobseekers according to the level of education in 2015 and 2016.

	Year 2015			Year 2016		
	Total	Female	Male	Total	Female	Male
Not In education	68.570	31.997	36.573	72.653	34.571	38.082
Elementary School	19.035	8.156	10.879	27.960	12.025	15.935
Secondary School	23.408	7.648	15.760	36.079	12.371	23.708
High School	471	163	308			
University	5.315	3.080	2.235	8.653	5.153	3.500
Master	247	108	139	462	222	240
PHD	-	-	-	-	-	-
	117.046			145.807		

Source: MPS, Department of Labour and Employment

Foreign direct investment (FDI)

FDI received in Kosovo was characterized by a sharp decline in 2016 compared to the previous year. In 2016, FDI was EUR 234.7 million, marking a noticeable decline by EUR 74 million. In 2015, FDI received in the country amounted to EUR 308.7 million, namely EUR 157.6 million more than in 2014. The significant increase of FDI in 2015 is attributed to the higher inflow of FDI compared to the previous year, but also the baseline effect, as 2014 was the year with the lowest level of FDI recorded in recent

years. In Kosovo, FDIs are mainly concentrated in the sectors of the economy such as real estate, construction, financial services, transport and communications, and energy.

The following table presents the FDI over the period 2014-2016 by country.

Foreign Direct Investments by country in million Euro												
	Total	Slovenia	Germany	Austria	Switzerland	UK	Turkey	The Netherlands	Albania	USA	France	Other
2014	151.3	(9.4)	29.4	30.1	38.2	(39.5)	20.2	(7.8)	20.4	14.6	3.0	59.0
2015	308.8	33.5	45.3	5.6	26.6	72.9	55.4	(36.4)	40.1	25.0	3.2	37.6
2016	234.8	10.1	28.7	(4.8)	32.7	61.8	35.2	(22.3)	28.6	22.5	2.8	39.5

Source: http://bqk-kos.org/repository/docs/2015/BQK_BMS_185_al.pdf

Energy and mining sector

Contributing factors to the problems of the energy sector

Almost all countries of the South-Eastern Europe face problems in covering energy demand. Especially in covering electricity demand all SEE countries are dependent on imports. Factors contributing problems associated with the energy sector in Kosovo are as follows:

- 1. Investments in generating capacities.** Despite the fact that Kosovo has significant lignite-based energy resources, since 1984 there has been no investment in the construction of new capacities or substantial rehabilitation of existing ones that would enable a stable electricity supply.
- 2. Investments in the distribution network system.** Insufficient investments in the electricity distribution system have led to a situation where the system cannot withstand the increased load, particularly in the winter season. This led to a level of technical losses which has further deteriorated the system.
- 3. High technical and non-technical losses** Non-technical losses as a result of unauthorized use of energy (theft) and the delivery of a significant amount of electricity in several municipalities in northern Kosovo, where the Distribution System Operator (DSO) and the supply company have no control, and as a result do not bill this amount of electricity.
- 4. Controls of cross-border electricity flows by the transmission system and market operator (KOSTT)** KOSTT, as transmission system operator, continues to have no control of cross-border electricity flow, which has also impacted on the ability of suppliers to achieve favorable contracts for electricity import. In 2015, KOSTT has signed a connection agreement with European Network of Transmission System Operators of Electricity (ENTSO) but this agreement is not yet in force.
- 5. Liberalization of the electricity market** In Kosovo there is still no effective open, free and competitive energy market. There is only one supplier who supplies all customers with regulated prices and has long-term power purchase agreements from all domestic producers. If there were more suppliers in the energy market in Kosovo the supply would be more stable.

6. Use of electricity for heating; Electricity is significantly used for heating of living spaces, water, cooking and sanitation. This is due to the lack of other alternatives to supply other energy products. Consequently, the household sector is the largest electricity consumer. When we add the uncontrolled and unauthorized use of electricity, the problem is further worse.

7. Non-rational use of energy Despite the considerable potential for energy savings, this potential is not being used sufficiently.

8. Renewable energy sources (RES) The use of renewable energy is also modest in meeting the needs of sanitary water heating in particular in the household and services sectors. If the energy-saving potential and RES were exploited better the electricity system would be in a better state and therefore the problems would be mitigated.

9. Small participation of thermal energy Despite significant improvements in the supply of heating from the cogeneration system, the share of heating energy from thermal energy (district heating) systems in final energy consumption is small compared to the possibilities.

10. Non-implementation of the feasibility study on natural gas Despite the opening of real opportunities for the inclusion of Kosovo in regional natural gas projects, we do not have a feasibility study for the construction of natural gas infrastructure.

The Government of Kosovo and policy-making institutions must undertake a range of activities to improve the situation in the situation in the energy sector in Kosovo, including:

- ❖ Harmonization of secondary and primary legislation with the EU acquis.
- ❖ Support of the construction process of Kosova e Re Power Plant;
- ❖ Support for the process of the project for rehabilitation of Kosovo B;
- ❖ Study on the need for investments for operation of TPP Kosovo A until the operationalization of new generation capacities.
- ❖ Liberalization of electricity market Activities on implementing measures to open the energy market under the guidelines of the Energy Community Secretariat;
- ❖ Application of the list of projects of common interest for the Energy Community for the natural gas project (along with Albania);
- ❖ Developing the process for the establishment of a common energy market with Albania;
- ❖ Approval of action plans for RES and EE and implementation of measures for their implementation;
- ❖ Activities in the process of transposition of EU legislation for energy efficiency, with a focus in efforts to finding modalities for the establishment of the Energy Efficiency Fund;

Challenges to the development of the mining sector

Kosovo's rapid and sustainable economic and social development will significantly depend on the implementation of Kosovo's mining policies and reforms. The current state of the mining sector prevents this goal from being achieved. Thus, reforms and restructuring of the mining sector are required based on the principles

of sustainable development and maximum benefit from the exploitation of resources.

❖ **The main economic challenges in the mining sector include:**

1. Funding, rehabilitation of existing mines and their prompt and cost-effective operationalization;
2. Mining sector SOE reorganization process;
3. Attraction of local and foreign investments in the mining sector, monetization and increased processing for certain minerals to produce full products or semi full products,
4. Harmonization of university programs with the mining sector needs and encouraging new generations in the development of this sector;
5. Further exploration for the identification of new mineral resources in Kosovo;
6. Development of the processing industry in the mining sector and finding new global markets;
7. Mining development for lignite production;

Government of Kosovo must ensure that mineral resources are only given for use if they maximize benefits for Kosovo, in the conditions of a free, open and transparent market. To this end, an attractive legal, regulatory and fiscal environment for investors should be created, providing Kosovo with the same level of income as countries positive experience in optimizing the use of mineral resources.

❖ **Adoption of mining sector development policies**

Mining development policies should be focused towards the adoption of legislation conducive of sustainable development of the sector, in line with international standards, attraction of private investments, full sector reforms, environmental protection and addressing social issues impacted by mining activity, as well as creation of sufficient institutional and professional capacities to respond to the challenges and develop the sector, in the context of a free and competitive market, ensuring they contribute to the country's economic development, in particular lignite resources, as well as lead and zinc.

❖ **Development of fiscal policies**

To promote the country's economic growth, fair and acceptable policies on the collection and utilization of mineral royalties should be developed, with a focus on new investments in infrastructure, industry and other activities that will affect employment growth, increased exports, lower imports and overall enhancement of community living standards.

❖ **Institutional development and human capacities**

Development of institutional and regulatory capacities, namely the functioning of institutions, such as the Kosovo Geological Institute and the State Museum of Crystals and Minerals, is another important issue.

❖ **Social Issues, Workplace Safety, and Community Benefits**

Safety, wellbeing and health of employees in the mining sector is an important obligation. Consultation with the community is essential in order to realize the full benefits of the mining activity, which not adequately developed in the past.

❖ **Environment protection - solutions to the environmental problems**

Environmental management should distinguish legacy environmental obligations and current environmental impacts generated by current and future mining

activities. Legacy environmental liabilities in the Republic of Kosovo are significant, and problematic areas resulting from the use of lignite and electricity generation have been identified. Trepça has had a long history of environmental problems, including toxic/acidic spills, fertilizers, emissions dust, uncontrolled wastes and non-stable landfills.

Doing business report 2016

The World Bank's Doing Business Report largely focuses on the regulatory and legislative framework governing each of the indicators measured in this report. Thus far, Kosovo has shown great readiness to amend primary and secondary legislation to align them with European directives and best international practices. Improvements in DB report do not provide a clear picture of the real developments in the country. The World Bank Group's latest Doing Business report recognized Kosovo's ongoing efforts to improve the regulatory climate for businesses. Of 189 countries that included in the survey, Kosovo is now ranked 66th. This is a major improvement compared to 2012, when it was ranked 126th.

Table 1 DB report for Kosovo 2016-2015

	DB 2016 Ranking	DB 2015 Ranking	Changes in ranking
Kosovo	66	64	-2
Starting a business	47	40	-7
Dealing with Construction Permits	136	137	1
Getting Electricity	124	118	-6
Registering Property	32	31	-1
Getting Credit	28	34	-4
Protecting Minority Investors	57	54	-3
Paying Taxes	67	64	-3
Trading across Borders	71	70	-1
Enforcing Contracts	48	46	-2
Resolving Insolvency	163	163	#

Source: <http://www.doingbusiness.org/data/exploreconomies/kosovo>

The Doing Business Report for 2016 had changes in methodology in five indicators: Obtaining Construction Permits, Electricity Connection, Contract Enforcement, Property Registration and Cross-Border Trade (Foreign Trade).

Kosovo's trade exchanges

A brief summary of trade illustrates best exports and imports in Kosovo for the period

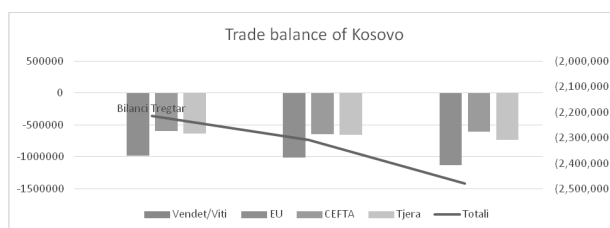
of three years. According to the data collected from CBK, KAS and TSH database, the following brief review of trade exchanges over the period 2014-2016 is presented. The following is detailed overview of Kosovo's trade exchanges with EU, CEFTA countries and other countries.

Trade Balance in goods 2014 – 2016 (value in '000 Euro)

Country/ Year	Exports			Imports			Trade Balance		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
EU	98.086	106.052	70.061	1,081,042	1,112,892	1,202,165	(982.956)	(1,006,840)	(1,132,105)
CEFTA	127.146	123.747	144.263	720.382	769.366	753.307	(593.236)	(645.619)	(609.044)
Other	99.311	95.495	95.363	736.986	752.435	834.235	(637.675)	(656.940)	(738.872)
Total	324.543	325.294	309.687	2,538,410	2,634,693	2,789,707	(2,213,867)	(2,309,399)	(2,480,021)

Source: Ministry of Trade and Industry of Kosovo and author's calculations

Trade Balance of Kosovo 2014-2016



Author's elaboration, 2017

According to the data, Kosovo has a negative trade balance, i.e. Kosovo imports more than it exports. The lower level of exports indicates a lower production, which reflects a lower economic development and increased unemployment.

Findings and Recommendations

There is a noticeable increase of daily consumer prices each year in Kosovo, as a result of the rise in the prices of supplies, as over 60% of consumption products are imported. The number of unemployed people also increases monthly and yearly, as a result of the number of people who complete their studies and receive degrees. A significant number of graduates have skills' mismatch with labor market demands, which means that Kosovo must reform its education system and profile it to ensure that graduates have the professional skills required in market. Policy-making institutions should stimulate local produce, and secure a domestic market, as a minimum, by creating favorable fiscal policies for local producers. With the actual economic growth rate (3.5% average per annum), it will take Kosovo's economy 15 years to reach the

average level of economic development and GDP growth per capita. The failure to have economic growth is a consequence of having no manufacturing, which results in low exports. Local producers have no economic benefits to produce, as imports of the same products are cheaper than domestic produce. Bureaucracy should be avoided and unnecessary regulations that allow room for bribery and corruption by government officials should be eliminated. Laws should be adopted to stimulate investors and ensure private and foreign investment.

For energy - The Government of Kosovo and policy makers should undertake a series of activities to improve the situation in the energy sector in Kosovo, such as:

Harmonization of legislation with the EU acquis, support for construction and investment of new technologies, market liberalization and environmental protection, increased efficiency, and deepening of cooperation with Albania and other countries.

For Mining - The Government of Kosovo should ensure that mineral resources are given for use, ensuring maximized benefits for Kosovo, in the conditions of a free, open and transparent market. To this end, an attractive legal, regulatory and fiscal environment should be created for investors, providing Kosovo with the same level of income as the countries with positive experiences in the optimization of the use of mineral resources, policies should be developed to stimulate economic development, attract investors and give security to businesses.

Kosovo has significant issues in all areas; Accountability is at the lowest level, punishment for illegal acts is almost nonexistent, as a result of inefficiencies in the judiciary, rule of law is poor and yet to be improved. Fight against organized crime and corruption remains only a rhetoric of high state officials. The instability of governance has negatively affected the attraction of FDIs.

The informal economy, especially in the northern part of the country, challenges sustainable long-term economic development.

Unfair competition and monopolization of large companies, the source capital of which is often unknown, are major problems for local small and medium businesses. The problem is not lack of laws and harmonization with EU acquis, but rather their poor implementation in practice.

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